

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

AMEREN ILLINOIS COMPANY)	
d/b/a Ameren Illinois)	
Petitioner)	
)	Docket No. 13-0476
Revenue-neutral tariff changes)	
related to rate design.)	

INITIAL BRIEF OF
THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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The People of the State of Illinois, by Attorney General Lisa Madigan (“AG” or “the People”) submit the following Initial Brief in this proceeding.

I. INTRODUCTION

A. Introduction

This proceeding presents the Commission’s first opportunity to evaluate Ameren’s cost allocation and rate design since the inception of formula rates in 2012. Pursuant to Section 16-108.5(e) of the Public Utilities Act, this proceeding is a revenue-neutral review of the Company’s electric delivery service rate design. It also represents an important opportunity to re-evaluate the Commission’s past endorsement of Ameren’s Straight Fixed Variable (“SFV”) rate design, which inequitably assigns excessive cost recovery to small users and diminishes customers’ ability to control their bill by increasing the fixed customer charge and reducing the variable portion of the distribution service bill. Consistent with its decision in the recent ComEd Section 16-108.5(e) rate design docket¹ to move away from a SFV design and return to cost-based rates for residential customers, the Commission should adopt the residential rate design for

¹ Order, Docket No. 13-0387, December 18, 2013.

Ameren customers recommended by AG witness Scott Rubin, which equitably assigns revenue recovery based on both fixed customer charges and usage charges.

The People's brief will describe how the inequities associated with SFV rate design ignore long-established principles of cost-causation, create unfair cross-subsidies between low-use and high-use customers within the residential classes and will continue to unfairly burden those consumers most in need of the Commission's protection. AG witness and rate design expert Scott J. Rubin's testimony explains how the SFV approach perpetuates these inequities, and in fact exacerbates them. However, the policies underlying the SFV approach are no longer relevant to Ameren in view of the revenue guarantees contained in the formula rates regulatory scheme implemented in 2012. Mr. Rubin presents a cost-based rate design using Ameren's own cost of service studies that will recover the Company's fixed and variable costs in a manner consistent with cost of service principles and in a way that eliminates the unfairness of SFV rates. This rate design should be adopted by the Commission.

The People also propose, following the recommendations of Mr. Rubin, that (1) Ameren's cost of service study be modified to reflect a more accurate allocator than Ameren proposes for the costs of non-metering AMI plant and (2) the Electric Distribution Tax subsidy currently enjoyed by DS-4 customers be phased out more quickly than Ameren proposes. In evaluating all of Ameren's rate design proposals, the Commission should be mindful of the need to accurately and fairly allocate costs to the customers that drive those costs.

B. Nature of AIC's Operations

C. Legal Standard

The Commission is charged with examining customer rate impacts of a proposed rate design under Illinois law. *Citizens Utility Bd. V. Ill. Comm. Comm'n*, 276 Ill.App.3d 730, 738

(1st Dist. 1995) (“The Commission could not meet its duty to ‘protect[] the interests of the ratepayers’ without taking into account the varying effect of rate restructuring on consumers.” (quoting *Citizens for a Better Env’t v. Ill. Com. Comm’n*, 103 Ill.App.3d 133, 142, 430 N.E.2d 684 (1981))). As such, the Commission should carefully look at the *varying* impacts of Ameren’s proposed rate redesign upon various customers or classes of customers, as well as the varying impacts of the People’s proposals. Additionally, in reviewing rate design proposals and consistent with the establishment of fair and equitable rates, the Commission should apply the principle of cost causation: those customers who cause particular service costs should pay for those costs. 220 ILCS 5/1-102(d)(iii) (“It is further declared that the goals and objectives of [public utility] regulation shall be to ensure . . . Equity: the fair treatment of consumers and investors in order that . . . the cost of supplying public utility services is allocated to those who cause the costs to be incurred”).

Pursuant to Section 16-108.5(e), the Commission must reach a decision in this proceeding within 240 days from the initial filing, which would be March 20, 2014 at the latest, and the resulting rate design would be implemented when the revenue requirement from the Company’s 2014 annual formula rate update is implemented in January 2015. AIC Ex. 1.0 at 4:83-5:90. Following the Commission’s final order in this proceeding, the Company must file a new rate design proposal (or re-file the existing rate design) within each subsequent 3-year period, pursuant to Section 16-108.5(e).

II. COST ALLOCATION

A. Resolved Issues

B. Contested Issues

i. Allocator for Primary Distribution Line Cost

ii. Allocation of Single-Phase and Three-Phase Primary Facility Costs

iii. Allocator for Non-Meter AMI General and Intangible Plant

Ameren proposes four modifications to the Embedded Cost of Service Study that affect cost allocations to the delivery service rate classes: supply and service voltage, primary distribution lines, overhead distribution lines, and advanced meter infrastructure (“AMI”) investment. AIC Ex. 2.0 at 7:125-130. The People accept the first three modifications, but disagree with the position on allocation of AMI investment.

The Company is proposing to allocate the costs of *non-meter* AMI plant using the customer-related allocation factor, CUST370, which is the same allocator used for the cost of AMI meters. AIC Ex. 2.0 at 15:309-16:326. For example, in Rate Zone I, 85.9% of customers are residential (DS-1) and Ameren’s proposed CUST370 allocator would allocate 84.0% of AMI costs to the residential class. AG Ex. 1.0 at 4:91-93. Company witness Schonhoff argues that the existing allocation method captures the benefits of AMI investments because AMI investments “support the metering function” including the benefit of decreased meter reading expenses. This argument fails to recognize the substantial non-meter related effects of AMI, however. The People propose, following the suggestion² of AG witness Rubin, allocating non-metering AMI plant costs using the LABOR allocator that is used for all general plant, until

² AG Ex. 1.0 at 7:151-156.

Ameren's next electric rate design case, when the issue should be revisited in light of actual data on AMI installations.

There are several reasons why the customer-based CUST370 allocator is inappropriate for non-metering AMI costs.³ First, AMI investment does not necessarily occur in proportion to the number of customers, due to variances in costs for meters of different sizes and loads, as well as differences in installation costs depending on the characteristics of customers. AG Ex. 1.0 at 5:112-115. Second, the benefits of AMI investment are not limited to the traditional metering function. In June 2012, Ameren filed an AMI Cost/Benefit Analysis with the Commission in Docket No. 12-0244.⁴ The Company's analysis in its AMI Cost/Benefit Analysis identified over a dozen different types of benefits from AMI. In addition to reducing meter reading costs, benefits included reducing unaccounted-for energy, improving outage management, enhancing reliability, improving load reduction programs, saving information technology costs, and enhancing the competitive electricity supply market, among others. As Mr. Rubin noted in direct testimony (AG Ex. 1.0 at 7:136-140), in the year 2016, Ameren suggested that AMI will save \$11.8 million, but the savings in manual meter reading that year will be only \$3.6 million.⁵

Ameren's proposed allocator would fail to effectively match AMI costs to benefits by customer class. Mr. Rubin showed in AG Exhibit 2.2 that, based on figures provided in Ameren's Exhibit 3.1RH (Rev.) in the AMI proceeding, Docket No. 12-0244, the DS-1 class is expected to receive approximately 64% of the estimated benefits from AMI. AG Ex. 2.2 at 2. Ameren's proposal would have the DS-1 class pay 84% of AMI capital costs, while Mr. Rubin's proposed LABOR allocator for non-meter AMI plant would result in the DS-1 customer class

³ AG Ex. 1.0 at 7:145-8:161.

⁴ Ameren Illinois Company, Petition for Approval of Smart Grid Advanced Metering Infrastructure Deployment Plan, Docket No. 12-0244, AIC Ex. 3.1RH (Rev.).

⁵ Docket No. 12-0244, AIC Ex. 3.1RH (Rev.) at 49.

paying 71% of the estimated AMI capital costs (*id.*) – which is not entirely fair to those customers, but is fairer than Ameren’s proposal. For the DS-2 class, Mr. Rubin showed that the class would receive approximately 26% of AMI benefits. AG Ex. 2.2 at 3. Ameren’s proposal would only charge DS-2 customers approximately 15% of AMI costs, significantly less than the benefits they would receive. Mr. Rubin moderates that proposal to have DS-2 customers pay approximately 19% of AMI costs, which are still less than the benefits that class is expected to receive. *Id.* Mr. Rubin also showed that the DS-5 class would receive approximately 2% of AMI benefits and pay essentially no AMI costs under Ameren’s plan. AG Ex. 2.2 at 4; AG Ex. 2.0 at 13:270-271. Mr. Rubin’s proposal to use the LABOR allocator would allocate approximately 2% of AMI costs to the DS-5 class. AG Ex. 2.2 at 4.

AIC witness Schonhoff suggested in his rebuttal testimony that a discussion of the benefits of AMI is “largely misplaced in this docket” (AIC Ex. 5.0 at 39:795). However, as he stated in his very next sentence, “a goal of a cost of service study is to identify costs and allocate those costs to the rate classes as they are incurred” (*id.* at 39:796-797). The allocation of costs to rate classes depends on properly allocated costs based on cost causation, as Mr. Schonhoff admitted in his surrebuttal testimony (AIC Ex. 8.0 at 29:629-631). The benefits provided by AMI are driving AMI installation and the costs associated with those benefits should be accurately allocated in AIC’s cost of service study. The categories of alleged AMI benefits tell us the functions that the AMI network is supposed to perform for Ameren. AG Ex. 2.0 at 11:229-230. Moreover, as discussed above, the rate design process should properly match costs with benefits. *Id.* at 12:235-236. Mr. Schonhoff, though, did not attempt to functionalize the non-meter AMI infrastructure or match benefits with costs for the various customer classes. *Id.* at 12:243-249.

Mr. Schonhoff stated in surrebuttal testimony that, because the non-metering AMI plant is necessary for the functioning of the AMI meters, “for each component of the AMI network, the cost causer is the end user of the meter, the customer” (AIC Ex. 8.0 at 31:672-674). However, while the non-metering AMI assets may be necessary to support the meter-reading function, they are also necessary to support other functions. AG Ex. 2.0 at 10:203-205. Under cross-examination, Mr. Schonhoff, asked to explain his contention that the non-meter AMI plan will *not* benefit the network as a whole and will instead benefit customers on a per-customer basis, admitted that he is “not an expert on the AMI,” that various AMI functions “appear to benefit customers,” and that “[o]ther than that, I don’t really have a good response.” Tr. at 52:19 to 53:1. While Mr. Schonhoff pointed in his surrebuttal testimony to the replacement of manual meter reading as an important function of AMI (AIC Ex. 8.0 at 30:633-638), he also admitted during cross-examination that Mr. Rubin correctly identified in his rebuttal testimony several other functions to be performed by AMI: outage management and response, uncollectible accounts, service disconnection and reconnection, and energy efficiency. Tr. at 50:15 to 51:6. Mr. Schonhoff provided no evidence to suggest that these functions provide benefits that should be allocated as a per-customer cost, regardless of customer characteristic. This is an implausible assumption on its face. High-use customers have more at stake when they enjoy the benefit of energy efficiency or outage management than do low-use customers, for example.

For these reasons, the CUST370 allocation for non-meter AMI plant proposed by Ameren in its cost of service study is not an accurate or fair allocation for customers. Because a proper allocation of cost will depend on the characteristics of customers and the specific equipment used, it is not possible to develop an accurate cost allocation methodology until the costs have been incurred. As Mr. Schonhoff admitted during cross-examination, the Company

has not yet begun installing non-meter AMI infrastructure. Tr. at 51:7-13. The People propose using the LABOR allocator in AIC's cost of service studies for non-meter AMI installations in annual formula rate updates from now until Ameren's next rate design case. This allocation can be re-evaluated in Ameren's next rate design proceeding three years hence in light of actual data on AMI installations that may occur between now and then. AG Ex. 1.0 at 8:159-161.

III. REVENUE ALLOCATION

A. Resolved Issues

B. Contested Issues

i. Revenue Allocation Methodology – Rate Moderation

1. Treatment of Electricity Distribution Tax

Both Ameren and the People are in agreement that the unjustified subsidy given to DS-4 customers in relation to the Electricity Distribution Tax ("EDT") must end. While Ameren proposes to prolong the phase-out of this subsidy over three years or more, the People believe that there is no good reason to continue it past the over 15 years it has already persisted.

Pursuant to 35 ILCS 620/2a.1, the Illinois Department of Revenue levies the EDT on a per-kilowatt-hour basis upon electric delivery utility companies, based on a schedule of differing tax rates for seven progressively increasing "brackets" of kWh delivery.⁶ The highest bracket is for kilowatt-hours distributed above 18 billion annually; Ameren's marginal kilowatt-hour always falls into this bracket each year.⁷ As AIC witness Jones stated in direct testimony, revenue recovered from DS-4 customers for the Company's EDT charge is below the EDT cost

⁶ AIC Ex. 1.0 at 18:371-374; AG Cross-Exhibit 2.

⁷ Per column B, line 900 on page 14 of AIC Exhibit 1.3, the Company distributes approximately 36.9 billion kilowatt-hours annually.

the Company incurs for these customers. AIC Ex. 1.0 at 17:356. The DS-4 class provides 10%, or \$4.2 million, of total EDT revenue to the Company, while DS-4 customers purchase 41.7% of total kWh sales. AIC Ex. 1.0 at 22:454-455. DS-4 customers thus should, based on their electricity purchases, contribute 41.7%, or \$17.5 million, of EDT revenue to the Company. AIC Ex. 1.0 at 23:456-457.

The difference between the DS-4 class's 10% revenue contribution and its use of 41.7% of all kWh demonstrates that customers in the DS-1, DS-2, DS-3, and DS-5 classes are providing substantial subsidies to DS-4 customers, amounting to approximately \$13 million annually. AG Ex. 1.0 at 9:178-179; AIC Ex. 1.0 at 23:464-470. Further, residential and other small customers have been subsidizing large DS-4 customers since the EDT was enacted in 1997. AG Ex. 1.0 at 8:169-170. It is past time for this subsidy to end.

As AIC witness Jones explains in testimony, in 2010, the Commission allowed continuation of the subsidy to the DS-4 class because the Commission's order in Docket No. 09-0306 (cons.) placed certain rate mitigation constraints upon the increase to any one class. This resulted in the disparities among customer classes within each rate zone shown at page 19, line 406 of AIC Exhibit 1.0. However, the Commission stated in its order in Docket No. 09-0306 (cons.) at 243, "[p]roperly assigning these [EDT] costs to the cost causers is clearly important to both customers and the Commission." And as AG witness Rubin notes, properly assigning the EDT costs to cost causers is not difficult: "[w]e know with certainty precisely how much of this [EDT] cost is the responsibility of each and every customer," and no estimates or calculations are needed as with other cost allocation problems. AG Ex. 1.0 at 9:195-10:203.

For DS-1 customers and DS-4 +100kV customers, the per-kilowatt-hour EDT charges levied (i) using revenue requirement from Docket No. 13-0301 and the current Ameren rate

design, (ii) using Ameren’s proposed new rate design, and (iii) using the AG’s proposed new rate design are as follows:

Table 1.

	EDT Charge (per kWh) DS-1 Class			EDT Charge (per kWh) DS-4 +100kV Class		
	Rate Zone I	Rate Zone II	Rate Zone III	Rate Zone I	Rate Zone II	Rate Zone III
Docket 13-0301	\$0.0017933 ⁸	\$0.0017883 ⁹	\$0.0017158 ¹⁰	\$0.0001004 ¹¹	\$0.0001108 ¹²	\$0.0000837 ¹³
AIC proposed	\$0.0014181 ¹⁴	\$0.0013129 ¹⁵	\$0.0013874 ¹⁶	\$0.0006294 ¹⁷	\$0.0011013 ¹⁸	\$0.0006642 ¹⁹
AG proposed ²⁰	\$0.0012061	\$0.0012061	\$0.0012061	\$0.0012061	\$0.0012061	\$0.0012061

It is clear that under the Company’s current rate design, DS-1 customers pay approximately seventeen times more per kilowatt-hour for the EDT charge than DS-4 +100kV customers do (*compare, e.g.,* \$0.0017933 and \$0.0001004); under the Company’s proposed redesign, the residential customer would still pay approximately one or two times more than DS-4 customers, depending on rate zone, in January 2015 rates. The People, as discussed in greater detail below, propose charging every customer class, regardless of rate zone, the same per-kWh EDT charge, equal to the Company’s average EDT paid to the state Department of Revenue per kilowatt-hour.

Ameren witness Mr. Jones states that there is no reason for different customer classes to pay different EDT charges as shown in Table 1; all customer classes and subclasses should pay

⁸ Data from AIC Ex. 2.7.

⁹ Data from AIC Ex. 2.7.

¹⁰ Data from AIC Ex. 2.7.

¹¹ AIC Ex. 1.3, page 5, line 309.

¹² AIC Ex. 1.3, page 6, line 371.

¹³ AIC Ex. 1.3, page 7, line 433.

¹⁴ Data from AIC Ex. 2.7.

¹⁵ Data from AIC Ex. 2.7.

¹⁶ Data from AIC Ex. 2.7.

¹⁷ AIC Ex. 1.3, page 5, line 309.

¹⁸ AIC Ex. 1.3, page 6, line 371.

¹⁹ AIC Ex. 1.3, page 7, line 433.

²⁰ AG Ex. 1.0 at 11:222.

the same average per-kWh EDT price. AIC Ex. 1.0 at 22:441-443. Thus, the Company wants to end the EDT subsidy given to DS-4 customers. However, the Company does not propose to definitively end the subsidy immediately; rather, the Company's proposal, which would include the narrowing of inter-class EDT subsidies in its overall rate mitigation framework, merely "could" result in elimination of the EDT subsidy to DS-4 customers within the next three or fewer annual formula rate update proceedings. AIC Ex. 1.0 at 23:475-24:479.

Mr. Jones agreed during cross-examination that, using figures shown in the Company's Exhibit 1.3, which he sponsored, the gap between the EDT charge currently paid to the Company by a Rate Zone I DS-4 customer for a marginal kilowatt-hour delivered (\$0.0001004 per kilowatt-hour) and the EDT cost that the Company owes to the Illinois Department of Revenue for the same marginal kWh (\$0.00131 per kilowatt-hour²¹) results in a loss to the Company of approximately \$12,000 for a hypothetical ten million marginal kilowatt-hours in a year. Tr. at 89:2-90:15. Under the Company's proposed new EDT charge for Rate Zone I DS-4 customers, which would multiply the current charge by approximately six times in 2015, Mr. Jones admitted that the Company would receive approximately \$6,000 of EDT revenue instead of the current \$1,000 (Tr. at 90:16-91:6) for the hypothetical marginal ten million kilowatt-hours. This change would mean that the Company would recover approximately \$7,000, instead of \$12,000, less than cost for the marginal ten million kWhs. Mr. Jones agreed during cross-examination that DS-4 customers are presently being subsidized by all other customers for the Company's EDT-related loss (Tr. at 91:12-19); that, should the Company's proposed phase-out of the subsidy outlined at pages 4-5 of AIC Exhibit 1.1²² be adopted, this subsidy would not be ended until, at the earliest, the second annual formula rate update following adoption of the new rate design;

²¹ AG Cross-Exhibit 1 at 2.

²² The proposed EDT subsidy phase-out is also summarized at AIC Ex. 1.0 at 25:501-513.

and that he “[did] not believe” it would continue beyond the third year. Tr. at 91:20-92:2. Mr. Jones did not, however, guarantee that the subsidy would end in the third year -- 2018.

The People, however, urge the Commission not to tarry in ending the EDT subsidy; rather, in this proceeding, the Commission should direct that all customer classes across all rate zones pay the same average per-kWh EDT charge, as shown in Table 1 above. Now is an opportune time to end the subsidy because the base component of distribution rates is declining; as Mr. Rubin calculated, under Ameren’s proposed rates in this case, the DS-4 class’s share of rate reduction is approximately \$3.5 million, excluding EDT charge adjustments, meaning that ending the \$13 million EDT subsidy to DS-4 customers would increase that class’s rates by less than \$10 million, or less than 20% of distribution rates. AG Ex. 1.0 at 10:208-214. It is a significantly smaller percentage of their total electric distribution and supply costs. DS-4 customers have been enjoying an unwarranted subsidy in relation to the EDT for over 15 years, and the time is long past to end it.

2. Rate Mitigation Alternatives

IV. RATE DESIGN

A. Resolved Issues

B. Contested Issues

i. Transformation Capacity Charge for Rate Zone II DS-4 +100kV

ii. Seasonally Differentiated Rates for the DS-3 and DS-4 Classes

iii. Use of SFV Rate Design for DS-1 Customer Charge

In its never-ending quest to eliminate all revenue recovery risk, Ameren proposes to extend its existing modified SFV rate design for residential customer classes, which currently collects 44.8% of distribution-related costs through the flat customer and meter charges, regardless of the amount of electricity a customer uses.²³ As observed by AG witness Rubin, until a few years ago and consistent with fundamental ratemaking principles, utility rates were set based on the cost of providing service to customers. AG Ex. 1.0 at 14:278-280. Demand-related costs were assigned to customers without demand meters in proportion to their measured electricity usage. *Id.* at 15:298-300. SFV rates, by contrast, are based on the notion that most of a utility's distribution costs are "fixed" costs regardless of whether they are allocated as demand or customer related, and that those fixed" costs should be collected from customers through "fixed" charges. Moreover, SFV rates for residential customers treat demand-related costs as being exactly the same for each customer, regardless of the amount of electricity used by the customer (and regardless of actual demand, which usually cannot be measured). AG Ex. 1.0 at 14:296-15:298.

²³ In the Commission's Order of April 29, 2010 in ICC Docket No. 09-0306 (cons.), a SFV percentage of 39% was approved at pages 283 and 286. The Company's current SFV percentage for the DS-1, or residential, customer class is 44.8%. AIC Ex. 2.0 at 23:445-456.

While the Company would like to rely on rate design orders from an older legislative environment, the Commission recently revisited its prior acceptance of SFV rate designs, in light of the 2011 passage of the Energy Infrastructure Modernization Act (“EIMA”). Just last month, in a December 18, 2013 order in ComEd’s rate design case under Section 16-108.5(e) of EIMA, Docket No. 13-0387, the Commission began phasing out SFV rate design for ComEd, moving to align residential customer pricing with the fact that an electric delivery service company’s costs are both customer and demand-related, and that rates should include a usage component that reasonably reflects demand-related costs. That Order should be used as a model in this docket. The Docket No. 13-0387 order is discussed further below.

Ameren promoted and the Commission has endorsed the SFV rate structure over the last several years, based on the claim that the utility could not recover its fixed costs without maximizing the fixed monthly customer charge. That policy, unfortunately, means that a customer living in a studio apartment without air conditioning pays the same customer charge as a customer residing in the highest energy-using penthouse condominium, with a steadily-dwindling percentage of the electric delivery service bill subject to customer usage control. AG Ex. 1.0 at 15:306-308. SFV pricing, the record evidence shows, has left Ameren’s lowest users of electricity shouldering the highest percentage of the increases in customer rates over the last several years, with the Company’s highest users, in some instances, experiencing rate *decreases*, as shown in AG Exhibit 1.01.

The modified SFV rate structure promoted by Ameren is particularly inequitable given the evidence that Ameren’s own embedded cost of service study (“ECOSS”) shows that a significant portion – 71.9%²⁴ – of the Company’s distribution costs is, in fact, variable relative to the demand placed on the system by its customers, while only 28.1% of the Company’s

²⁴ AG Ex. 1.0 at 16:319-321; AG Ex. 1.13; AG Ex. 2.0 at 3:49-50.

distribution costs are customer-related and therefore fixed. Ameren's own customer data, carefully analyzed by AG witness and rate design expert Scott J. Rubin, reveals the significant cross-subsidies of high-usage residential customers by low-usage residential customers that exist in the Company's current modified SFV rate design. Moving from a traditional rate design to SFV rate design has shifted demand costs from higher-use customers to lower-use customers. AG Ex. 1.0 at 16:324-325. As discussed above, under a traditional rate design, essentially all non-customer-related distribution costs would be allocated on a per-kWh basis. Under a pure SFV rate design, nearly all distribution costs would be allocated on a per-customer basis. Customers who use relatively small amounts of electricity will and have seen very large rate increases under an SFV type of rate design, while customers who use relatively large amounts of electricity will and have seen their bills increase very little or even decline. *Id.* at 325-331.

These cross-subsidies are not only inherently inequitable, given that higher-usage customers place greater demand on the Ameren distribution system, but also diminish *all* customers' ability to affect their electricity expenses and their incentive to decrease their energy usage. A rate design policy that minimizes customers' ability to reduce their bill by controlling their energy usage contradicts the clear public policy of the State of Illinois, which seeks to reduce energy usage and promote energy efficiency.²⁵

For the DS-1 and DS-2 customer classes, the Company is proposing in this proceeding to recover 50% of its revenue requirement via fixed bill components and 50% via volumetric components. AIC Ex. 1.1 at 3; AIC Ex. 2.0 at 22:443-444. The Company proposes to increase the SFV percentage for DS-1 customers from the current 44.8% to 50% in 2.5 percentage point

²⁵ See, e.g., Section 8-103 of the Public Utilities Act, which provides: "It is the policy of the State that electric utilities are required to use cost-effective energy efficiency and demand-response measures to reduce delivery load. Requiring investment in cost-effective energy efficiency and demand-response measures will reduce direct and indirect costs to consumers by decreasing environmental impacts and by avoiding or delaying the need for new generation, transmission, and distribution infrastructure." 220 ILCS 5/8-103.

increments annually (AIC Ex. 7.0 at 19:428-429), so that 50% will be achieved in the third iteration of annual new rates starting in January 2015, i.e. in January 2017 (Tr. at 48:17-49:2).

As an initial matter, the People note that “[r]ate design should not be based on some number plucked out of thin air . . . it should be based on actual data from the ECOSS²⁶, coupled with a recognition of long-standing regulatory policies (such as fairness and gradualism).” AG Ex. 2.0 at 2:35-39. However, when asked why the Company chose to propose that it recover 50% of revenue from DS-1 and DS-2 customers through fixed-bill components, Company witness Schonhoff could only refer, in direct testimony²⁷ and under cross-examination²⁸, to the Commission’s order in Docket No. 10-0467 (May 24, 2011), in which it approved a SFV rate design for ComEd that entailed recovering 50% of revenue through fixed billing components. Asked to provide other reasons for the 50% figure, Mr. Schonhoff stated that “the only variable cost is the Electric Distribution Tax”²⁹ and that “the Company’s . . . current percentages of straight fixed variable were relatively close to that number.”³⁰ Company witness Jones, asked the same question in cross-examination, cited the Commission’s decision in the same Docket No. 10-0467 case (Tr. at 69:23-24). Mr. Jones also testified that the percentage of Ameren’s electric distribution costs that is fixed is not identical to the percentage of ComEd’s electric distribution costs that is fixed (Tr. at 70:19-20); despite this fact, the Company has still chosen to use ComEd’s SFV percentage. Mr. Jones also stated that the Company did not consider any other figures than 50% (Tr. at 73:12-18). While Mr. Jones’s surrebuttal testimony states that “[t]he proposed continuation of the modified SFV rate design would recover at least a portion of [demand-related] costs from all customers” (AIC Ex. 7.0 at 21:468-470), he did not attempt to

²⁶ ECOSS stands for Embedded Cost of Service Study.

²⁷ AIC Ex. 2.0 at 22:451-23:454.

²⁸ Tr. at 39:18-23.

²⁹ Tr. at 44:19-20.

³⁰ Tr. at 45:17-20.

explain why such portion should amount to approximately $22/72 = 30.6\%$.³¹ (As discussed above, approximately 72% of costs are demand-related. Thus, recovery of 50% of all costs by fixed billing components suggests that approximately 22 percentage points of the 72% demand-related costs are recovered in the fixed charges.) It is clear that Ameren witnesses did not offer any evidence tying their 50% SFV proposal to Ameren's cost of service study or actual costs.

Scott Rubin's Analysis of SFV Rate Impacts

AG witness Rubin showed in his direct testimony the impact of the Company's move toward SFV rates since 2007. He started with a data set containing 2012 usage for all DS-1, or residential, customers. AG Ex. 1.0 at 17:351-252. He then excluded customers that did not have a full 12 months of data, or contained months with negative usage. *Id.* at 18:362-363. He grouped³² the 802,622 remaining customers into 20 ventile groups, ranked according to their annual usage: i.e., the 5% of customers with the lowest usage, then the 5% of customers falling into the sixth through tenth percentile of usage, the 5% of customers falling into the eleventh through fifteenth percentile of usage, and so forth, up to the 5% of customers with the highest usage (ninety-sixth through hundredth percentile). *Id.* at 18:376-380. For each of these ventile groups, Mr. Rubin calculated that ventile group's total annual consumption and that ventile group's total consumption during the month of August, which Mr. Rubin determined to be generally the peak month. *Id.* at 19:388-390. For each customer in the data set, Mr. Rubin then calculated the total annual bill under 2007 rates and under 2013 rates. *Id.* at 19:391-397. Finally, for each ventile group, Mr. Rubin calculated the total revenues collected annually from that group and compared this to the embedded cost of service for the group using the ECOSS,

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³² To be clear, Mr. Rubin is not advocating that the residential DS-1 class should be divided into 20-subclasses with 20 different rate structures; he advocates a common customer, meter, and volumetric charge for the entire residential class in each rate zone. AG Ex. 2.0 at 7:138-146.

considering that customer-related costs make up 28.1% of the total class embedded cost, as discussed above. AG Ex. 1.0 at 20:405-407; 21:437-446. Mr. Rubin's analysis, contained in AG Exhibits 1.01 through 1.12 and reproduced as Exhibit A to this Initial Brief, shows, among other things:

- The lowest-usage ventile group is responsible for 1.9% of distribution costs in the DS-1 customer class but pays 2.6% of revenues in the class, up from 2.0% in 2007. This group, the members of which each use under 3,117 kWh annually, has seen an average annual rate increase of approximately 50.3%.
- The highest-usage ventile group is responsible for 10.1% of distribution costs in the DS-1 customer class but pays just 8.7% of revenues in the class, down from 10.6% in 2007. This group, the members of which each use in excess of 24,190 kWh annually, has seen an average annual rate *decrease* of 4.5%.

Mr. Rubin observed that the average customer in the highest-use ventile group uses more electricity in *two days* than an average customer in the lowest-use ventile group uses in *one month*. AG Ex. 1.0 at 24:499-504. Mr. Rubin stated that “there is absolutely no way that these customers place the same peak demand on the electric distribution system and their rates should not pretend that they do.” *Id.* at 24:504-505.

In order to eliminate the disparity between revenues and cost causation within the residential class, Mr. Rubin proposed a straightforward re-alignment of the customer and volumetric charges that reflects residential customers' contribution to demand costs while collecting the same overall level of revenues from the class and eliminating the inequitable cross-subsidy of high-usage customers by low-usage customers that currently exists. Under Mr. Rubin's proposed rate redesign, the Company would recover approximately 28% of its revenue requirement through fixed billing components, which is the percent of electric delivery service costs that are customer-related and thus fixed, as shown on the Company's ECOSS and

explicated by Mr. Rubin at AG Exhibit 1.13. AG Ex. 1.0 at 25:514-516. Mr. Rubin chose not to change Ameren's proposed meter charge of \$4.14 and instead reduced the Company's proposed customer charge from \$11.46 down to \$5.17³³, so that the fixed-component revenue recovered from residential customers would match the customer cost. *Id.* at 25:521-524. Mr. Rubin then modified the volumetric charge in each rate zone to (i) recover the remaining residential revenue requirement for that rate zone; (ii) maintain the same relationship as presently exists among summer and non-summer rates; and (iii) maintain the same relationship as presently exists among the non-summer first 800 kWh block and the non-summer over-800 kWh block. *Id.* at 25:525-530. Mr. Rubin's proposed rate design, which significantly increases the volumetric charges and significantly decreases the customer charge for the DS-1 customer class, can be found at AG Exhibit 1.14, which is attached to this Initial Brief as Exhibit B.

The remainder of this section explains further why it is important to charge customers on a volumetric basis for demand-related costs and thus why the Commission should adopt Mr. Rubin's proposed rate design for the DS-1 customer class.

The Commission's Recent Commonwealth Edison Decision

Mr. Jones stated in rebuttal testimony that Mr. Rubin's proposal to end SFV pricing "is contrary to the Commission's preference to recover fixed costs through fixed charges." AIC Ex. 4.0 at 33:712-713. He cited the Commission's order in Ameren's second-most-recent gas rate case, Docket No. 11-0282, in which the Commission stated that its policy is to "allow recovery of a greater portion of fixed costs through the customer charge." AIC Ex. 4.0 at 26:551-555. He also cited the Commission's decision in Ameren's last electric rate design proceeding, Docket No. 09-0306 (cons.). *Id.* at 26:559-561. However, Mr. Jones's premise that the Commission categorically supports SFV pricing is no longer so stalwart. As a result of 2011's passage of the

³³ By contrast, Ameren proposes to *increase* the customer charge to \$12.12.

EIMA legislation, Ameren now recovers its rates under the formula rate structure, which includes a reconciliation of historical costs, rates and revenues. 220 ILCS 5/16-108.5(d); Docket Nos. 12-0001, 12-0193, 13-0301. As a result, Ameren no longer bears the revenue uncertainty associated with traditional ratemaking, wherein the Company bore the risk of revenue recovery exceeding or falling short of the authorized revenue requirement.

Further, following the evidentiary hearing in this proceeding, the Commission addressed the SFV paradigm in its Order dated December 18, 2013 in Docket No. 13-0387, ComEd's electric service rate design case. The Commission noted that the AG's proposal for residential classes was "based on the assumption that demand costs are proportionate to usage and more equitably allocate the cost of service than the present SFV" and "gets to a more equitable allocation of costs by a simpler design which reduces customer charges within two residential subclasses and upwardly adjusts the per kilowatt usage charge to reflect what it asserts are more accurate calculations of fixed and variable costs." Order at 74.

In the ComEd case, the Commission adopted the AG's rate design proposal for residential classes in full, noting that the People's proposal to "decrease the fixed customer charge and increase the variable charge" for single-family customers "is straightforward and consistent with traditional rate design principles" and "rebalances fixed and variable costs and more closely aligns customer's bills with the cost of service, especially for many low use customers." Order at 75. The Commission should take a similar approach in this proceeding and adopt a rate design that appropriately matches revenues recovered with the costs generated by various customers.

Variable vs. Fixed Costs

A key dispute between the People and the Company in this proceeding is whether the Company's demand-related costs should properly be classified as variable, as the People argue, or whether they are largely fixed, as the Company asserts. In the field of economics, whether a cost is fixed or variable depends on the time period that is evaluated. The shorter the time period, the more costs will be fixed. AG Ex. 1.0 at 12:243-245. For example, as a hypothetical, assume a utility pole has a useful life of 33 years, so that on average 3% of poles are replaced each year. If fixed costs are evaluated for the next year, 97% of a utility's investment in poles will be fixed, but 3% (the poles that will be replaced next year) will be variable. If the analysis is extended to five years, then 85% of the investment would be fixed and 15% would be variable. *Id.* at 12:245-250. However, because "[a] residential customer's fluctuation in usage in [a] one year time period between rate cases will not cause a fluctuation in utility pole costs" (AIC Ex. 4.0 at 27:583-585), and because the Company budgets expenditures one year in advance (AIC Ex. 7.0 at 23:510), the Company asserts that essentially all distribution costs are "fixed," except for the volumetric EDT obligation discussed above. But this view is not reasonable, as Mr. Rubin explained in direct testimony. Many of the Company's expenses can be quickly adjusted in response to changing circumstances, and the Company should constantly be attempting to improve its operating efficiency and negotiate better terms with suppliers, notwithstanding its previously-established budget. AG Ex. 1.0 at 13:262-264. Day-to-day management of utility expenses and investments assumes the ability to control costs in response to changing conditions and underlies the regulatory bargain.

AG witness Rubin noted in his direct testimony that the Company's proposed SFV rate design for DS-1 customers is not supported by actual data in the Company's ECOSS. Company

witness Jones confirmed in cross-examination that the Company's proposed 50% SFV percentage was not motivated by the Company's ECOSS (Tr. at 73:8-11). However, Mr. Jones stated in surrebuttal testimony that some of the costs grouped in the ECOSS as *demand-related* (and not customer-related) should be viewed as fixed because "[a]ll of the costs recognized in the revenue requirement have already been incurred (or will have been incurred by the end of the year)." AIC Ex. 7.0 at 20:448-449; see also *id.* at 24:535-536. Mr. Jones argued that "[t]he distribution system is designed to serve the expected peak of the customer at the time facilities are installed" (*id.* at 20:461-462) and that "[w]hether the customer chooses to use an amount lower than the expected or design peak demand does not change the costs of facilities installed" (*id.* at 20:462-21:463). However, Mr. Jones does not allow for the reality that a customer's peak demand in a given year is positively correlated with its peak demand in other years and thus with that customer's *expected* peak demand, and that the Company will make marginal plant installation or retirement decisions on this basis, as discussed below.

Even if it were true that "[a] residential customer's fluctuation in usage in [a] one year time period between rate cases will not cause a fluctuation in utility pole costs" (AIC Ex. 4.0 at 27:583-585) or that "[c]ustomers using more or less energy in a year have little to no impact on the Company's operation and maintenance costs" (*id.* at 27:594-595; also see *id.* at 28:603-605), it is not clear that one year is the appropriate time span for evaluating which costs are variable. If the Company, hypothetically, strictly waited two years from the last plant upgrade before upgrading any portion of its distribution plant, but made plant upgrade decisions based solely on changes in demand or kWh usage, then it would be possible to say that one-year customer usage fluctuations are not, taken alone, driving plant upgrades, but even under this hypothetical, it would be absurd to say that customers are not driving plant upgrades with their volumetric usage.

Mr. Rubin cited a passage from Professor James Bonbright's seminal 1961 textbook, *Principles of Public Utility Rates*, stating that "the more significant marginal or incremental costs are those of a relatively long-run variety – of a variety which treats even capital costs or 'capacity costs' as variable costs." AG Ex. 2.0 at 3:56-61. Mr. Rubin then noted that, as an example of Professor Bonbright's point, transformers and reclosers might last 10 years or more and utility poles might last 30-40 years; all such facilities are sized, built, and replaced based on customer demand. *Id.* at 4:62-65. Company witness Jones attempted to rebut Mr. Rubin's quoted citation from the Bonbright textbook, quoting a subsequent section of the textbook stating that "short-run marginal costs should not be ignored, but they should be used with caution." AIC Ex. 7.0 at 21:484-485. However, as Mr. Jones admitted during cross-examination, the ratemaking policy proffered by Mr. Rubin from the Bonbright textbook does not advocate setting rates based on short-run marginal costs. Tr. at 75:7-10. Moreover, Mr. Jones agreed that the Company could incur marginal or incremental costs of a long-run variety. Tr. at 75:17-23; 76:11-17. Mr. Jones stated that "all costs are a long-term or incremental cost potentially" (Tr. at 76:24-77:1) and agreed that under this definition, utility poles, transformers, and substations could be considered a long-run marginal cost (Tr. at 77:2-78:2). It is these costs, to the extent they are demand-related, that the Commission should treat as variable for purposes of designing rates.

Mr. Jones agreed that, if a class of customers showed a significant increase in demand of 20% over a five-year period, "it is possible that somewhere along the distribution system additional plant would have to be installed" (Tr. at 79:15-22), thus contradicting his assertion in rebuttal testimony that "[u]tility poles are . . . recorded as a fixed asset and booked accordingly to plant. Once installed, the cost of utility poles does not vary with customer usage" (AIC Ex. 4.0

at 26:568-570). Mr. Jones stated that, if the hypothetical increase manifested over just three years, the distribution planners “would likely probably study what is causing that level of demand growth to mak[e] a decision on what investment is needed to serve customers, if any.” While Mr. Jones focused on the demand-related costs purportedly allocable to a hypothetical “zero-use” customer (AIC Ex. 7.0 at 543-552; see also AIC Ex. 4.0 at 29:631-30:649), he failed to refute the notion that zero use in one year is likely correlated with zero or low use in another year (which is plausible given his examples of “vacation homes” or “a garage or shed”) and thus would make a small-to-zero contribution to Company planners’ estimation of expected peak demand.

In contrast to Mr. Jones’s position, Mr. Rubin points out in his rebuttal testimony that his analysis does not assume that non-customer-related costs allocated to a zero-use residential customer are zero, but he does assume that such non-customer-related costs for a zero-use customer are lower than for a positive-use customer. AG Ex. 2.0 at 5:101-102. As Mr. Rubin observed in his rebuttal testimony (AG Ex. 2.0 at 6:108-121), Company witness Schonhoff’s exhibit explaining his ECOSS recognized “the fundamental principle of cost causation in that the equipment [i.e. line transformers] is sized to meet the individual peak demands of individual customers rather than the collective [coincident peak] demands of all customers.”³⁴

While Mr. Jones stated in rebuttal testimony that “[a] substantial cost is incurred to be ready to provide [a] customer electricity if desired” (AIC Ex. 4.0 at 29:636-637) and that “[s]ystem costs are fixed, and stand ready to serve customers whether used or not” (*id.* at 30:649), he also admitted during cross-examination that the Company “design[s] the system to serve the maximum expected demand of customers.” Tr. at 81:18-19. Although Mr. Jones surprisingly stated that he was unaware how the Company’s planners determine expected

³⁴ AIC Ex. 2.1 at 4:187-5:199.

demand of customers (Tr. at 82:18-19), it is straightforward to infer that, at a high level of generality, the Company's planners look at actual past demand of individual customers, aggregated to the system level. A customer with regularly high demand thus contributes more to drive system costs than a customer with regularly low demand. AG Ex. 2.0 at 3:47-49; 5:101-103. Over a few years, the putative low-use customer will make a smaller contribution to the Company's estimate of system-wide demand and thus to new plant installation.

Effect on Space-Heating Customers

Company witness Jones alleged in his rebuttal testimony that Mr. Rubin's proposed rate design would "negatively impact electric space heating customers, a group that tends to be high-use within the residential class." AIC Ex. 4.0 at 33:714-716. However, Mr. Rubin prepared an analysis as part of his rebuttal testimony to show the effect of his proposal upon space-heating residential customers. As a rough indicator of space-heating customers, he focused on customers with a winter peak month consumption at least twice that of the summer peak month consumption; 54,549 customers met this criterion. He found that, while 23% of these customers saw their annual bills decline when SFV rate design was introduced in 2007, 14% of these customers had annual bill increases of over 40%. AG Ex. 2.0 at 8:159-9:177; AG Ex. 2.1. Company witness Jones attempted to refute Mr. Rubin's analysis in AIC Exhibit 7.1, which used Company information to identify space-heating customers. However, his chart at AIC Ex. 7.1, taken with his statements that "[t]he average electric heat customer uses closer to 14,000 kWh per year" and "[a]bout 32% of electric heat customers use 18,000 kWh or more annually" (AIC Ex. 7.0 at 26:579-584), shows only that a minority of space-heat customers would experience a rate increase when transitioning from the Company's proposed rate redesign to the People's proposed rate redesign. It appears from AIC Exhibit 7.1 that space-heating customers who use

less than 18,000 kWh annually (which comprises the majority of space-heating customers, according to Mr. Jones's statements) will pay less under the People's proposal than under the Company's proposal.

Energy Efficiency Implications

In addition to the inequitable cost-shifting from high users to low users that is triggered by SFV rates, this marked increase in fixed monthly charges means residential customers have less ability to affect their bill for utility service and less incentive to engage in energy efficiency. That fact contravenes the clear direction from the Illinois General Assembly for utilities to engage customers in ratepayer-funded energy efficiency programs and thereby reduce the demand for electricity.

Specifically, Section 8-103 of the Public Utilities Act provides:

It is the policy of the State that electric utilities are required to use cost-effective energy efficiency and demand-response measures to reduce delivery load. Requiring investment in cost-effective energy efficiency and demand-response measures will reduce direct and indirect costs to consumers by decreasing environmental impacts and by avoiding or delaying the need for new generation, transmission, and distribution infrastructure.

SFV rates, however, reduce a customer's incentive and ability to reduce his or her electric usage. For this reason, too, the Commission should re-visit its past endorsement of SFV rates and adopt Mr. Rubin's proposed residential rate design. While Company witness Jones stated in surrebuttal testimony that "the retention of a modified SFV rate design mitigates the potential downside impact of promoting energy efficiency program to customers. In other words, a SFV design positively influences the Company's desire to help customers operate efficiently" (AIC Ex. 7.0 at 23:528-530; emphasis and quotation marks omitted), he failed to note that the

Company has a statutory mandate to help customers use energy efficiently, regardless of its “desire” or lack thereof.

Moreover, in the extreme, if the Company could always recover all of its revenue requirement through fixed per-customer billing components, then it would always be assured of recovering its authorized revenue requirement each year (assuming it correctly forecasted the number of customers); to the extent that its revenue requirement is recovered through volumetric charges, its cost recovery may be variable due to weather. Mr. Jones stated in rebuttal testimony that “[t]he Company’s incentives to operate efficiently are the same under both pricing scenarios” (AIC Ex. 4.0 at 28:617), but this ignores that if its costs are recovered automatically through the customer charge, and then reconciled annually, then Ameren has no incentive to reduce costs and improve efficiency. AG Ex. 2.0 at 5:86-90. Simply stated: Why would the Company look at making its purchasing more efficient or economical if it is guaranteed recovery of 100% of its costs regardless of demand or service? Why would it seek to reduce the number of vehicle-miles traveled if it is guaranteed recovery of 100% of its vehicle fuel and maintenance costs? These are truly variable costs – they may be changed very quickly – but the definition used by Ameren incorrectly treats these costs as fixed costs. AG Ex. 1.0 at 13:268-275.

Finally, regardless of how the Commission views fixed cost recovery issues, Ameren’s participation in the annual formula rate process under EIMA now ensures that the Company’s rates are annually updated to recover the Company’s actual costs and forecasted plant expenditures. This shift in the regulatory paradigm eviscerates any utility argument that unless monthly customer charges are maximized (thereby minimizing the effect customer usage has on revenue recovery), it will not recover its costs. As the Commission recently stated in the ComEd rate design case, Docket No. 13-0387, it is “likely that ComEd’s financial risks have been

reduced due to EIMA.” Order, December 18, 2013, at 75. The record evidence and these changes in electric utility revenue recovery support a restructuring of Ameren’s rates to reduce the fixed monthly customer charge and increase the variable per-kilowatt-hour charges in order to end the inequitable cross-subsidization of high-usage customers by low-usage customers, who ironically place the least demand on the Ameren distribution system yet have seen the largest percentage increases in rates since the movement toward the modified SFV structure. Such a restructuring, too, will further incent residential ratepayers to participate in the energy efficiency programs for which they already pay, and serve the General Assembly’s policy goals of reducing electric usage.

Summary

The Rubin analysis clearly demonstrates that the percentage of cost recovery assigned to the customer and meter charges for the DS-1 class must be reduced to ensure that rates reflect cost causation for that class. In addition, principles of equity and fairness demand that users of small amounts of electricity not shoulder more of the cost recovery burden than their demand and contribution to cost justify. Similarly, high-usage customers should not be rewarded with lower percentage increases in rates when their contribution to cost causation is higher than other customers within their subclass. The cost-based rates developed by Mr. Rubin will significantly reduce the current subsidies of high users by low users and result in more fair and equitable rates. Except for some minor differences, the revenues received from each ventile group of customers would be approximately equal to the cost of serving each such group. A correct understanding of fixed versus variable costs, a focus on space-heating customers, a concern for energy efficiency, and, perhaps most importantly, a regard for the recent ComEd rate design order all

militate in favor of adopting the People's proposed rate redesign for DS-1 customers, contained at Exhibit B to this Initial Brief..

V. CONCLUSION

For the foregoing reasons, the People request that the Commission enter an order consistent with their arguments contained herein. The Commission should seize this opportunity to properly align cost causation and revenue recovery for Ameren's customers.

Respectfully submitted,

The People of the State of Illinois

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